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REORGANIZATION UNDER THE FEDERAL STATUTES *

CHAPTER X OF THE CHANDLER ACT

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HISTORY begins with trade, and the story of the debtor and his creditor appears on the first page. This true story is an absorbing one. It abounds in pathos and intrigue. It recounts the suffering of the innocent unfortunates and their eventual rescue, the frauds of the villainous and their inevitable punishment. Rigorous punishment for nonpayment of debts is recorded—death penalties, commitment into bondage and seizure of all the debtor's goods and chattels with the debtor still weighted down by deficiencies. Then the concept changes and severity relaxes. The debtor is discharged from his debts upon surrender of all his property. Later, he is allowed his homestead and tools as exempt. Finally, under the aegis of the bankruptcy power, relief is extended for the reorganization of a debtor, to salvage his business for social good, and to protect the creditor from the wastage of liquidation.

DEVELOPMENT OF BANKRUPTCY LAWS

Lifting the veil of antiquity, we discover that the first relief statute for an innocent debtor, caught in the "fell clutch of circumstance," appears on stone tablets carved by Hammurabi in the twenty-third century before Christ: "If any one owe a debt for a loan, and a storm prostrates the grain, or the harvest fail, or the grain does not grow for lack of water; in that year he need not give his creditor any grain, he washes his debt tablet

* Speech given Dec. 9, 1938, before Nordic Law Club of Chicago.

† Member, firm of Johnson, Swanstrom & Wiles; author, Chapter X — Corporate Reorganization Under the Federal Statute (Foundation Press, Chicago, 1938).

[a symbolical action indicating the inability to pay] and pays no rent for this year."¹

The biblical debt relief, known as "The Lord's Release," provided for the discharge of debts among the Jews every seventh year. This statute did not apply to foreigners. It was to be effective "save when there shall be no poor among you."² Apparently the relief afforded by the mandatory release of debts has not produced the condition subsequent that expressly limits the term during which the statute shall be effective, for the poor have been ever with us.

About eighteen hundred years after the date of the code of Hammurabi, Solon removed the mortgage pillars that covered most of the land of Greece and so granted relief from secured debts. He freed those in slavery for debt, and forbade contracts that put a debtor, his children, or dependent relatives into bondage by reason of debt. In Rome, the idea that punishment should follow debt default gradually gave way and was tempered to allow the redemption of debt slaves upon the posting of a bond, with a relative as surety.

In England, with the growth of the law merchant, there developed the notion of a general execution in favor of creditors of debtors engaged in certain businesses. The bankruptcy law, however, developed slowly. At the time our Constitution was adopted the English law recognized only the interests of the creditors and proceeded on the assumption that the debtor was necessarily to be dealt with as a wrongdoer. Voluntary bankruptcy was then unknown to that system, and only traders were permitted to fall within the term "bankrupt."

In this country the development of the law has been gradual. Bankruptcy legislation was usually enacted either during, or immediately subsequent to, the several periods when economic stress reached panic proportions. Each act was intended to furnish remedies for the most apparent defects in the economic system or from speculative excesses prevalent in a fast growing country. Hence, each succeeding law advanced beyond its predecessor in the relief afforded and the persons and subjects encompassed. Congress has passed four distinct bankruptcy laws, and many amendments, including the Chandler Act of 1938, which is a comprehensive revision as well as an amendment.

¹ Great Events by Famous Historians, Vol. I, p. 21.

² Deut. 15:1-4.

The first bankruptcy law, that of 1800, advanced beyond the then existing English law by including not only traders but also bankers, brokers, and underwriters. The second, that of 1841, made a further forward step by allowing voluntary petitions, thus recognizing that a debtor might be unfortunate and yet not an offender. The third law, that of 1867, with its amendment of 1874, permitted compositions before or after adjudication, and thus afforded a certain percentage of creditors the right, in agreement with the debtor, to abort the bankruptcy proceeding and yet provide a discharge upon agreed terms. This concept underlies the composition and reorganization sections, beginning with section 74 of 1933, which were passed as amendments to our fourth bankruptcy law, that of 1898.

The Chandler Act does not affect certain sections of Chapter VIII: Section 75, dealing with agricultural compositions and extensions; Section 77, dealing with reorganization of railroads engaged in interstate commerce; and Section 81, now Chapter IX, dealing with readjustment of debts of taxing districts.

The draftsmanship of the Chandler Act is an improvement over the old law by reason of a changed grouping whereby related parts are more logically arranged; certain ambiguities and contradictions have been removed, as have also many of the perplexities in appeals; and the provisions relating to participation in hearings and to compensation have been amplified. Generally, however, Chapter X embodies the provisions of 77B and codifies much of the case law developed under that section.

Chapter XI permits, by voluntary petition of any person who could become a bankrupt under Section 4 thereof, the making of arrangements affecting unsecured debts. Chapter XII permits, by voluntary petition of persons other than corporations, real property arrangements. While a petition under Chapter XII must have as its primary object the readjustment of secured claims, unsecured debts may be treated. A complete reorganization of the debt structure of an individual, including liens, may now be accomplished under this chapter. Much of the case law developed under Section 77B will be applicable under Chapter XII. It is worthy of note that the report of the Committee on the Judiciary states that it is expected that Chapter XII will afford necessary remedies for conditions arising in the Chicago metropolitan area growing out of the practice of real estate financing by bond issues

Chapter XIII deals with wage earners' plans and embodies a new concept in that future earnings may be brought within the control of the court. Chapter XIV deals with maritime liens.

The technique employed in legislating on reorganization has been to superimpose a code on the fundamental bankruptcy power and the jurisprudence developed in general equity. With certain excepted sections, Chapters I to VII inclusive of the old Bankruptcy Act, and the equity jurisprudence are carried forward by reference, hedged, however, by the qualification that the provisions or rules from such fields shall not apply in the code for reorganization if they are inconsistent or in conflict with the provisions of the particular reorganization chapter. This method of legislating gives rise to serious problems of interpretation. The provisions of Chapter X apply, however, exclusively to proceedings under that chapter. This is true also with respect to Chapters XI, XII, and XIII.

The reorganization statutes were passed to afford greater and more comprehensive relief in debtor and creditor problems than was obtainable in ordinary bankruptcy or equity receivership. While a proceeding under Chapter X is a proceeding in bankruptcy, it is not an ordinary bankruptcy, for its objective is different, and it stops short of liquidation sale and the distribution of cash dividends—its goal is rehabilitation and therefore permits payment in securities. Neither is it the equivalent of an equity receivership; rather it is a hybrid of bankruptcy administration and equity jurisprudence, and a step beyond each.

Chapter X is but one segment in a great body of Federal statutory reorganization law. It contains some advanced social-economic concepts, the wisdom of certain of which only time and practice can definitely test. It appears that the estate of the debtor passes not only into *custodia legis* as formerly, but, under this new law it also falls into the radius of *custodia regis*. Private contracts and the reorganization of business corporations have apparently become the especial concern of the state. General public interest is presumed to be advanced by the gratuitous and voluntary protection afforded investors and other creditors through the participation in, and the censorship of, the proceedings by a governmental agency, the Securities and Exchange Commission.³ Certain classes of society, such as labor organiza-

³ Chapter X, sec. 172.

tions with no property interest except possibly that of individual economic weal for the class, may partake in the reorganization of a distressed debtor-employer by advancing ideas as to the economic soundness of a plan.⁴ The motives and purposes of non-acceptors, as well as acceptors of a plan, are subject to judicial inquiry with the possible disqualification as voters for lack of good faith.⁵ Intermittent refunding of debt is discouraged and eventual payment is required.⁶ Forthright and nonpartisan representation is expected to result from provisions that search out impurity of motives which might actuate agents and committees, and that set up disciplinary measures as safeguards.⁷ Self-interest is stifled by mandatory disinterested trusteeship even at the expense of pride of ownership.⁸ Only time and practice can demonstrate whether these provisions will achieve the desired end without too great a sacrifice of property rights and substantial values.

INTERPRETATION

The interpretation and application of the statute should be made with regard for its historical background, the legal concepts from which it springs, and its purposes and the ultimate objectives sought to be achieved, as well as the evils it seeks to end. Creditors give up their old remedies with reluctance; yet, when additional remedies are afforded they must be given effect when invoked. The amelioration of the situation of the oppressed debtor is, however, necessarily slow in development in order that a proper check may be made on the debt evaders and that a vitality may be preserved in contracts for the protection of trade and commerce.

The bankruptcy remedial amendments since 1933 have laid the foundation for the creation of a permanent body of case law. This development can best be traced and understood by examination of all the opinions of the several courts with regard to the date of each opinion and the locale of the proceeding. The several metropolitan centers produce their peculiar problems and develop their own individual solutions to such problems. So the various sections of the country, with great regional diversification of its industries and commercial activities, may solve their problems with varying degrees of uniformity. In recognition of these chang-

⁴ *Ibid.*, sec. 206.

⁷ *Ibid.*, secs. 211, 213, 249.

⁵ *Ibid.*, sec. 203.

⁸ *Ibid.*, sec. 156.

⁶ *Ibid.*, sec. 216(9).

ing and variable factors, the reorganization amendments to the bankruptcy law are devised to leave to the discretion of the judge the final determination of the most important matters arising in the administration of the law, the administration of which is of equal importance to the law itself.

POWER

The source of the Congressional power to enact bankruptcy laws is in Article I, Section 8, of the Constitution. To understand better the extent of this power, one must keep in mind the history of its exercise by progressive extension to wider and wider fields as well as the judicial interpretation of the various laws on the subject which defines the power.

Congress responded to the present depression, drawing more fully upon the latent bankruptcy power to furnish relief in the debtor-creditor relationship, by providing mechanics for reorganization. This has been held not to be an unconstitutional exercise of the power. The power has not been enlarged; it was always there. Its greater use has given it animation to function as needed. It must be expected that the growth of commercial relations, bringing practical business problems into the life of almost every individual, will find the facilities and mechanics of the old bankruptcy laws insufficient to meet the requirements of the debtor and creditor readjustment which necessarily follows.

It is now recognized that once a person is found to be insolvent in the absolute or limited sense, Congress has paramount jurisdiction under the bankruptcy power to provide for the sale of his assets, or for reorganization and the readjustment of the debt structure. Every aspect of the affairs of an insolvent person can be dealt with under the power subject only to Constitutional limitations.

Limitations on the bankruptcy power are not specially enumerated in the Constitution. It is definitely established now that the power is not measured or limited by the English law as it existed at the time our Federal Constitution was adopted, and that adjudication and liquidation are not essential to jurisdiction.⁹ The power is, however, subject to the Fifth Amendment, which requires due process of law when property is to be taken from

⁹ *Continental Ill. Nat. Bank & Trust Co. v. Chicago, Rock Island & Pacific R. Co.*, 294 U.S. 648, 55 S. Ct. 595, 79 L. Ed. 1110 (1935).

any person. But due process is a flexible term whose definition lies in the last analysis in judicial temperament and background. So also the concept of bankruptcy changes.¹⁰

Our dual system of government gives rise to serious discussions in the field of bankruptcy law. States may legislate on the subject within the limits of the state and Federal constitutions. Such legislation, however, is suspended during the time that there exists a national bankruptcy law insofar as such state laws are in actual conflict with the Federal law.¹¹

The state creates corporations and limits their existence, but the state classification of corporations, such as insurance and banking, does not prevent a bankruptcy court from deciding whether or not as a matter of fact a certain corporation is amenable to bankruptcy, as whether it falls within or without the excepted class in the bankruptcy law.¹² So also the reorganized corporation cannot be incorporated except in conformity with the state laws of its incorporation. Congress has recognized that a state may make reasonable regulations relating to the operations of a business charged with great public interest, such as a public utility, and has provided in the bankruptcy law for approval of plans of such debtors by the commissions regulating such utilities.¹³ The bankruptcy courts generally recognize and follow the state law in determination both of property rights and of questions of general commercial law.¹⁴ Yet the bankruptcy law may give a landlord a remedy against the estate not afforded by the state law.¹⁵ The validity of state taxes may be determined by the bankruptcy court and payment directed. State court decrees and judgments are generally recognized, but their effect in the bankruptcy estate is controlled by the Bankruptcy Act. Where the state court judgment is for fees in foreclosure cases, there must be a direction to pay; otherwise, the bankruptcy court re-examines the value of the services and the amount of the allow-

¹⁰ *Wright v. Union Cent. Life Ins. Co.*, 304 U.S. 502, 58 S. Ct. 1025, 82 L. Ed. 1490 (1938).

¹¹ *Chicago Title & Trust Co. v. 4136 Wilcox Bldg. Corp.*, 302 U.S. 120, 58 S. Ct. 125, 82 L. Ed. 147 (1937).

¹² *In re Prudence Co., Inc.*, 79 F. (2d) 77 (1935).

¹³ Chapter X, secs. 177, 178.

¹⁴ *Erie R. Co. v. Tompkins*, 304 U.S. 64, 58 S. Ct. 817, 82 L. Ed. 1188, 114 A.L.R. 1487 (1938).

¹⁵ *City Bank Farmers Trust Co. v. Irving Trust Co.*, 299 U.S. 433, 57 S. Ct. 292, 81 L. Ed. 324 (1937).

ance.¹⁶ Property rights as established by state law may be modified by bankruptcy law; for example, the period set by state statute within which property may be redeemed in foreclosure may be prolonged by bankruptcy law.¹⁷

The bankruptcy court has the power with which it is invested by Congress. The Bankruptcy Act must be examined to see if the power or jurisdiction has been granted in all instances where the question of jurisdiction arises. If jurisdiction is granted, it is paramount. In reorganization, jurisdiction is extended to cover every person and thing that can be brought into the radius of the debtor and creditor relationship.

Express limitations on the bankruptcy court are found in the Act. Such limitations do not follow necessarily by reason of lack of congressional power, but from lack of exercise of the power.¹⁸ For example, Section 23 provides that, with certain exceptions, suits by the receiver or trustee shall be brought only in the court where the bankrupt might have sued if there had been no bankruptcy, unless by the consent of the defendant. By reason of this, plenary suits are required in controversies unless the defendant submits to the jurisdiction of the bankruptcy court. This rule was followed in Section 77B cases.¹⁹ Chapter X expressly makes Section 23 inapplicable, but Chapter XII does not. The courts must decide the limit, therefore, of their jurisdiction in these particulars under the present law.

The law, as respects due process and state sovereignty, is not precisely defined. The state of flux found here is demonstrated by two recent decisions of the Supreme Court interpreting Section 80, dealing with readjustments of municipal debts. In May, 1936, the court held the section unconstitutional, and in April, 1938, it held the revised section constitutional. The rationale in the two opinions is not in harmony. There was a shift in the personnel of the court. Mr. Justice McReynolds wrote the opinion in the first case, with Justices Hughes, Cardozo, and Stone dissenting; the

¹⁶ *Shulman v. Wilson-Sheridan Hotel Co.*, 301 U.S. 172, 57 S. Ct. 680, 81 L. Ed. 986 (1937), rehearing den., 301 U.S. 714, 57 S. Ct. 921, 81 L. Ed. 1365 (1937).

¹⁷ *Wright v. Union Central Life Ins. Co.*, 304 U.S. 502, 58 S. Ct. 1025, 82 L. Ed. 1490 (1938).

¹⁸ *Taubel-Scott-Kitzmiller Co. v. Fox*, 264 U.S. 426, 44 S. Ct. 396, 68 L. Ed. 770 (1924).

¹⁹ *In re Chicago & N. W. Ry. Co.*, 86 F. (2d) 508 (1936); *In re Prima Co.*, 98 F. (2d) 952 (1938), in which the court said that not to apply the rule would constitute a repeal of sec. 23 insofar as reorganization matters are concerned.

opinion in the other case was by Chief Justice Hughes, with Justices McReynolds and Butler dissenting. In the first case,²⁰ the court said that the law restricted the control of the State over its fiscal affairs; that state sovereignty cannot be surrendered; that the consent of the State cannot enlarge the powers of Congress. In the second case,²¹ the court stated that the State had consented; that States may consent to contracts which do not contravene the Federal Constitution; that ability to make contracts is the essence of sovereignty; and finally, that by co-operation of the state and Federal governments the only remedy possible could be afforded.

INITIATION OF PROCEEDINGS

The amenability of the debtor organization is determined by the bankruptcy law. To come under Chapter X the organization must be a corporation as defined in the Act. Questions relating to eligibility of unincorporated bodies, newly organized corporations, excepted corporations and subsidiaries will not be discussed.

Proceedings may be initiated by petition of the debtor or of three or more creditors having claims against the debtor, or against its property, amounting to at least \$5000, or by the indenture trustee.²² The petition may be answered or controverted by the debtor, by any creditor, by the indenture trustee, and by any stockholder if the debtor is not found to be insolvent.²³ The requirement of Section 77B for group action is dropped from Chapter X.

The venue is determined by the location of the debtor's principal place of business or its principal assets.²⁴ The provision of Section 77B permitting the filing of a petition in any district in the state of incorporation is dropped from Chapter X. Proceedings may be transferred to such place as will best subserve the interests of the parties without regard to the location of the assets or office.²⁵

The necessary allegations of the petition are prescribed categorically.²⁶ To overcome the effect of the Duparquet decision,²⁷ which held that a foreclosure receivership was not the

²⁰ *Ashton v. Cameron*, 298 U. S. 513, 56 S. Ct. 892, 80 L. Ed. 1309 (1936).

²¹ *United States v. Bekins*, 304 U. S. 27, 58 S. Ct. 811, 82 L. Ed. 1137 (1938), rehearing den. 304 U. S. 589, 58 S. Ct. 1043, 1044, 82 L. Ed. 1549 (1938).

²² Chapter X, sec. 126.

²³ *Ibid.*, secs. 136, 137.

²⁴ *Ibid.*, sec. 128.

²⁵ *Ibid.*, sec. 118.

²⁶ *Ibid.*, secs. 130, 131.

²⁷ *Duparquet Huot & Moneuse Co. v. Evans*, 297 U. S. 216, 56 S. Ct. 412, 80 L. Ed. 591 (1936).

equivalent of a general "equity receivership," Chapter X expressly excuses the allegation of an act of bankruptcy if all or the greater part of the debtor's property is affected by trustee possession by reason of default, by appointment of a receiver or trustee, or by a proceeding to foreclose a mortgage or lien. The jurisdictional facts required by the chapter must be alleged and these facts must be such that when they have been determined by the court for the exercise of its jurisdiction, the judgment cannot be attacked collaterally.

The statute creates the jurisdiction of the court, and while a court may not extend its jurisdiction beyond the statute, it has the power to interpret the language of the statute and its application to an issue before it. It has the power to determine whether or not it has jurisdiction. This is the principle upon which the doctrine of *res judicata* rests which puts an end to litigation. A difference is recognized between strictly jurisdictional facts, the absence of which renders a judgment void, and quasi jurisdictional facts which are necessary to be alleged and proved in order to set the machinery of the law in motion. Examples of the former are the appointment of an administrator for a living person, or the adjudication of an insurance company as a bankrupt. Examples of the latter are the insufficiency of personal property to pay debts of a decedent when application is made to sell the real estate, or that an alleged bankrupt is a farmer.

The requirement of good faith has been retained in Chapter X. While Chapter XII does not expressly require good faith in the filing of the petition, the arrangement will not be confirmed unless it is made and accepted in good faith and a proposal must accompany the petition. Furthermore, "clean hands" must be present since the proceedings are essentially in equity. "Good faith" is not defined, although Section 146 specifies when good faith is lacking. This is but a restatement of the principles established in Section 77B cases. Good faith cannot be comprehensively defined. It connotes honesty, actuality, innocence, and absence of fraud, collusion, or deceit. It has been given a practical meaning, so that a possibility of reorganization must be thought to exist or good faith will be lacking. Mere "visionary or impracticable schemes of rehabilitations"²⁸ do not connote good

²⁸ *Tennessee Pub. Co. v. American Nat. Bank*, 299 U. S. 18, 57 S. Ct. 85, 81 L. Ed. 13 (1936)

faith. It is not, however, a mere formal concept demanding strict adherence without regard to the particular facts and circumstances of each case. It is not an evidential fact to be alleged in the petition; it is an ultimate fact to be found by the court from the evidential facts. It is a conclusion to be drawn, one way or the other, from the facts appearing in the petition, or appearing elsewhere or otherwise.

Representation by committees, agents or attorneys in the proceedings, though authorized, is especially scrutinized.²⁹ The provision requiring a showing that there has been compliance with all applicable law relating to such persons is significant.³⁰

Procedural questions arising after the approval of a petition, or of the powers of the court, or of jurisdictional questions will not be discussed. But attention is called to the new provisions relating to the rights of the indenture trustee; the Securities and Exchange Commission; the mandatory provision for the appointment of a trustee where the scheduled indebtedness is \$250,000 or more,³¹ and the new duties of the trustee, among which is the preparation of the plan and its proposal;³² the reference of the plan to the Securities and Exchange Commission³³ and its approval by the court before submission to the parties in interest;³⁴ the invalidation of acceptances solicited prior to such approval,³⁵ provisions that no gain is realized for income tax purposes by the cancellation or forgiveness of debts in reorganization;³⁶ and the inequitable, if not absurd, provision limiting the determination of the "bases" which effectually penalizes creditors for taking a loss on claims in that it reduces the exemptions for depreciation.³⁷

ADMINISTRATION

Administration is the fulcrum of the proceedings upon which is balanced the readjustment of the rights and equities of the actual parties in interest. The difference between administering an estate for reorganization instead of for liquidation is apparent. This real difference is preserved, or lost, mainly by the kind of administration to which the estate is subjected. The nature or quality of the administration of the debtor's business is most vital to creditors and stockholders working toward reorganization.

²⁹ Chapter X, sec. 211.

³² *Ibid.*, sec. 169.

³⁵ *Ibid.*, sec. 176.

³⁰ *Ibid.*, sec. 213.

³³ *Ibid.*, sec. 172.

³⁶ *Ibid.*, sec. 268.

³¹ *Ibid.*, sec., 156.

³⁴ *Ibid.*, secs. 173, 174.

³⁷ *Ibid.*, sec. 270.

The keynote of administration is the preservation and conservation of the debtor's business, good will and other assets, and the continuation of its business, and to insure these interests certificates of indebtedness may be issued.³⁸ These are the underlying principles in the cases. The affairs and assets of the debtor should be brought under one jurisdiction as promptly as possible and with no more interruption or disturbance of the regular prosecution of the debtor's business than is necessary, in order that the momentum of the business be not impeded and that all potentialities of reorganization may be preserved.

Normally the objective of the proceeding is not punitive, nor is the proceeding brought for the main purpose of investigation. The response, therefore, to the statutory emphasis in this respect³⁹ must be made in the exercise of good judgment to avoid lengthening unnecessarily the period of administration. It is common experience that acute financial distress of a debtor cannot be made chronic by over-prolonged court proceedings, without harm to all interested parties.

The debtor may be continued in possession in the interest of economy and preservation of the elusive good will that attaches itself to business. The status of the debtor in possession has been rather fully discussed. Without more, it may be said that whatever that status may be in respect of any particular matter, it is at least the status of a receiver. This unique method in sequestration proceedings was used extensively in 77B cases. Under Chapter X, however, a trustee must be appointed where the scheduled debts aggregate \$250,000 or more. This provision has been subjected to much criticism. Certainly the field of judicial discretion should be extended to cases where the claims aggregate at least \$1,000,000.

The trustee and his attorney must be disinterested.⁴⁰ The trustee is charged with many new functions under Chapter X. It is a concept of this chapter that he shall serve as the focal point for the formulation and negotiation of the plan of reorganization. He shall investigate the affairs of the corporation, and prepare informative documents for the use of the parties in interest and of the court. Somewhat similar duties fall upon the debtor when it is continued in possession, but under such cir-

³⁸ *In re Prima Co.*, 88 F. (2d) 785 (1937); Chapter X, sec. 116(2).

³⁹ Chapter X, sec. 167.

⁴⁰ *Ibid.*, secs. 156, 157.

cumstances the court may appoint an examiner to perform certain special duties of a trustee.⁴¹

STOCKHOLDERS' TREATMENT

Stockholders, of course, are vitally concerned with the question of the solvency or insolvency of the debtor because its financial condition may determine their participation in the proceedings and the plan. If the debtor is not insolvent, any stockholder may file an answer controverting the allegations of the original petition.⁴² Where the debtor is continued in possession, any stockholder may file a plan if the debtor is found not to be insolvent⁴³ and acceptances by or on behalf of stockholders holding the majority of the stock, of which proofs of each class have been filed and allowed, are required.⁴⁴ No protection need be provided in the plan for a class of stockholders of which the necessary majority has failed to accept if the judge shall determine that the debtor is insolvent.⁴⁵ Apparently stockholders have the right to be heard in all matters arising in a proceeding regardless of the solvency or insolvency of the debtor.⁴⁶

Since a solvent corporation may file a petition in bankruptcy it may be questioned whether or not an adjudication in a superseded proceeding is conclusive on the question of solvency or insolvency in the reorganization proceedings. To determine the status of solvency and insolvency, consideration of various factors is necessary, such as cost, reproduction cost, and use value. Recent sales of property similar to that of the debtor and the expected service life of the property have been considered. Fair rental value of the property is an important element. The Supreme Court has stated, however, that estimates of rental values during eras of depression are quite unreliable.⁴⁷ Audits and appraisals of expert appraisers are customarily used. The value of the whole undertaking as a going concern should be determined.

No standardization of methods can be established to control without exception in every case. In a period of general national distress, markets become glutted and cannot absorb the properties offered even at private sale by reason of the potential fore-

⁴¹ *Ibid.*, sec. 168.

⁴² *Ibid.*, sec. 137.

⁴³ *Ibid.*, sec. 170.

⁴⁴ *Ibid.*, sec. 179.

⁴⁵ *Ibid.*, sec. 216(8).

⁴⁶ *Ibid.*, sec. 206.

⁴⁷ *Kuehner v. Irving Trust Co.*, 299 U. S. 445, 57 S. Ct. 298, 81 L. Ed. 340 (1937).

closure sales overhanging the market. The appraisalment of personal property such as stocks, bonds, and commodities that normally have a stable market value may not be possible during certain periods, reoccurring apparently in uncomfortably short intervals, by reason of the erratic and spasmodic behavior of the stock and commodity markets. The necessary protection against price fluctuations, both for the borrower and the lender, must be found in the methods that the court will use in any particular case for the appraisalment of the value of the debtor's assets.

REORGANIZATION

Reorganization is readjustment and is essentially a business problem. It requires a frank approach to the realities in each case and a recognition that a compromise of rights and equities is inevitable. The objective of a proceeding under Chapter X is to effectuate a reorganization and to launch the debtor or its successor into business free and clear of stockholders' interests and creditors' claims, including tort claims and landlord's claims, except as they may be reserved in the plan or in the order confirming the plan.

The objective is not so much to change present contracts as to reform them, in order not only to relieve the debtor, but also to provide relief for its creditors; to remove conditions that have by the turn of events become so onerous that the debtor's business furnishes no yield to its creditors by payment of principal or interest; and to extend maturities, reduce interest or principal or both, or remove such of the conditions that prevent the regular payments to creditors. This is the public policy underlying Section 77B and Chapter X. It is not relief for the debtor solely, or for its creditors only, since relief to one is relief to the other.

Any scheme of reorganization which the imagination can conceive is permissible providing it is not violative of the statute or other law. The statute sets forth a catalog of requirements of, and suggestions for, a plan.⁴⁸ Certain of these are mandatory and certain permissive. Chapter X re-enacts the 77B provisions, but adds certain requirements such as the following: The manner of selection of directors, officers or voting trustees and their

⁴⁸ Chapter X, sec. 216.

successors must be set out, and the provisions relating thereto must be equitable and compatible with public interest; non-voting stock is prohibited and the voting power must be fairly distributed; provisions must be made for sound accounting practice, and adequate and fair provisions respecting the redemption of securities and the declaration of dividends; if the liquidated liabilities equal \$250,000 or more, provisions must be made for at least annual reports to security holders, including profit and loss statements and balance sheets.

Section 77B was used extensively as a method of foreclosing liens expeditiously with the elimination of the equity of redemption. With the added provisions of Chapter XII permitting the modification of mortgage liens in any manner, including the sale of the property free from liens, creditors are provided with convenient mechanics for realization of their claims even against an individual holding mortgaged property.

It is only the property of the debtor that may be encompassed by the reorganization. Hence, it has been held that a plan may not release guarantors or the claims of creditors against third persons for misrepresentation in the sale of securities. Claims for mismanagement of the debtor's property may, however, be released, for such release is a treatment of the debtor's property. The Supreme Court has recently held, reversing the Illinois Supreme Court, that if the order of confirmation releasing the guarantor entered after contest is not appealed from in the proceeding, it is binding on another court and the guarantor may plead *res judicata* against such suit. This is an example of a judgment that cannot be attacked collaterally. The reorganization court having determined the jurisdictional fact, another court may not retry such fact.⁴⁹

To use properly the term "property" regard must be had to the statute and the connection in which it is found.⁵⁰ Not only is the tangible thing property but also the right to use or operate such a thing by franchise, grant or custom. It may mean either the rights in the physical thing or the physical thing itself, or both. Such is the good will developed by the business, the habit of people to return to the same place to trade or to purchase goods under a certain name.

⁴⁹ *Stoll v. Gottlieb*, 59 S. Ct. 134, 83 L. Ed. Advance Opinions 116 (1938).

⁵⁰ *Fidelity & Deposit Co. v. Arenz*, 290 U. S. 66, 54 S. Ct. 16, 78 L. Ed. 176 (1933).

Written acceptances to the plan are required from creditors of each class holding two-thirds of the amount of the claims of such class, and of the majority of the capital stock of each class, if the debtor is not found to be insolvent. If the United States is a creditor, acceptances by the Secretary of the Treasury is required unless payment in full is provided. Such acceptance is presumed if the Secretary of the Treasury fails to act for more than ninety days after receipt of notice and copy of the plan.

When an accepted plan is presented for confirmation, there must appear compliance with all statutory requirements. There must be a showing in the record of sufficient facts from which the court can form an enlightened judgment and upon which it can exercise its discretion whether or not to confirm the plan as being fair, equitable and feasible.

Section 77B did not require court approval of a plan before submission to creditors and stockholders. Chapter X does. Furthermore, Chapter X prohibits solicitation of acceptances prior to such approval without the consent of the court.⁵¹ Section 77B recognized acceptances procured even prior to the filing of the petition⁵² as does also Chapter XII.⁵³ The emphasis is placed upon the solicitation and therefore acceptances voluntarily given before approval may be valid. At all events the court will have to decide what amounts to solicitation. Apparently the intent is to prohibit the practice of negotiating plans and testing their acceptability before going into court. This is a limitation on the freedom of private trading thought necessary to afford protection. Only by actual practice can the profit or loss from this rule be known.

The Supreme Court has not as yet passed upon the treatment in an accepted plan of dissenting minorities of a participating class. It has, however, approved the exclusion upon a basis of appraisalment of junior classes in the order of their rank by a senior class for want of any equity after the senior class has received satisfaction by appropriating the assets to itself.⁵⁴

While priorities between the respective classes are to be maintained as carefully as possible, a majority of the courts have not followed the so-called strict priority rule adopted in equity

⁵¹ Chapter X, sec. 176.

⁵² Section 77B(e), 11 U. S. C. A. §207(e).

⁵³ Chapter XII, sec. 436(4).

⁵⁴ *Re 620 Church St. Bldg. Corp.*, 299 U. S. 24, 57 S. Ct. 88, 81 L. Ed. 16 (1936).

receivership cases after the Boyd decision.⁵⁵ The courts have often permitted the participation of junior interests and stockholders where it seemed practical and agreeable with the purpose of the statute so to do, even though the relative priorities were not strictly and to the last detail followed. Reasons advanced for this may be the necessity for compromises, the value of the managerial skill, the personalities and their ability to retain the good will, and the value of the debtor's organization as a going concern. The doctrine of "*de minimis*" has likewise been applied. In reorganization proceedings, potency of fact surmounts authority of theory. Over-nice theories supported only by technicalities blossom well in the library, but they must yield to practical considerations dominant in the workshop and factory. The court sitting in Chapter X proceedings is a court in bankruptcy with a jurisdiction greater within the statute than that of a court of equity, and has a jurisdiction extended beyond that of a court sitting in strict bankruptcy.

Confusion may have been brought about in decisions by failure to differentiate clearly between accepted and nonaccepted plans. Furthermore, construction of vague and flexible statutory provisions often creates judicial expressions that are merely dicta, but which, because of their being euphonious, will be repeated in inapplicable as well as applicable situations and thereby become more or less authoritative. Such expressions as "completely compensatory" and "indubitable equivalents," used in an early case⁵⁶ in connection with a denial of a stay order against a mortgagee, have attracted such repetition. Equitable equivalents should be satisfactory, since realistically a demand for complete compensation in money in full at the moment may be futile. Such compensation is often found only in new securities made good or redeemed from the fruits of the labor of the debtor's managing stockholders.

The rule developed by the majority of the cases might be stated as follows: Applied equity is not opposed to participation in a common enterprise by junior interests on a parity with senior interests in proportions found fair and just by the judge, as guardian of the silent nonacceptors as well as the articulate

⁵⁵ Northern Pacific R. Co. v. Boyd, 228 U. S. 482, 33 S. Ct. 554, 57 L. Ed. 931 (1913).

⁵⁶ In re Murel Holding Corp., 75 F. (2d) 941 (1935).

objectors, under the peculiar exigencies of each reorganization problem, and when such participation does not result in oppression of minorities by accepting majorities.

There are provisions which make it possible for the court to confirm a plan though the required percentage of acceptances may not have been obtained for an affected class, provided adequate provision for the realization of the claims or interests of such class is provided.⁵⁷ These provisions are adopted from Section 77B⁵⁸ A similar provision appears in the Railroad Act, but with the requirement that such plan must also "conform to the requirements of the law of the land." The provision for the treatment of nonaccepting classes was used with indifferent success under 77B. The sixth circuit held the provision (77B,b-(5)) unconstitutional,⁵⁹ but this holding was made dictum inasmuch as the Supreme Court, while affirming the decision insofar as it dismissed the petition, held that the constitutional question was not involved.⁶⁰ The cases do not indicate that these statutory provisions are unconstitutional but rather that the use to which they may be put in a plan may make the plan unconstitutional.

"Realization" has been construed to imply that that which was in prospect has come to hand.⁶¹ Payment in cash of a claim is perfect realization, but realization may be accomplished under the provisions of Section 77B b(5). Security holders must, however, receive equitable equivalents for their security.⁶² The essential thing is to give the mortgagee the benefit of the value of his securities.⁶³

If the holders of claims or stock have, in bad faith, accepted or failed to accept a plan, the court is permitted under Section 203 of Chapter X to disqualify them from voting, and such claims are not computed in determining the requisite majority for the acceptance of the plan. The net effect of this provision, it seems, would be to lend flexibility to the fixed percentages required by Section 179; so Section 203 may be employed for

⁵⁷ Chapter X, sec. 216 (7&8).

⁵⁸ Section 77B(b), clauses (4) and (5), 11 U. S. C. A. §207(b).

⁵⁹ *In re Tennessee Pub. Co.*, 81 F. (2d) 463 (1936).

⁶⁰ *Tennessee Pub. Co. v. American Nat. Bank*, 299 U. S. 18, 57 S. Ct. 85, 81 L. Ed. 13 (1936).

⁶¹ *Texas Hotel Securities Corp. v. Waco Dev. Co.*, 87 F. (2d) 395 (1936), reh. den. (1937).

⁶² *In re New York, N. H. & H. R. Co.*, 16 F. Supp. 504 (1936).

⁶³ *In re Witherbee Court Corp.*, 88 F. (2d) 251 (1937).

effectuation of a plan where less than the required acceptances of a class are obtained. The latter emergency is met by clauses 7 and 8 of Section 216, which are incorporated to produce the result of an accepted plan. There is no magic in the 67 per cent and the 51 per cent, for Congress might have used some other percentages. There was no provision similar to Section 203 in Section 77B, and the provision thereof which required with acceptances verified statements relating to the claims purchased or transferred during or in contemplation of the proceedings was held not to extend to requiring investigation of the motives of nonacceptors.

ALLOWANCES

The amount of fees to be allowed is left to the discretion of the judge. The category of the persons who, under Chapter X, may be compensated has been enlarged over the comparable provisions in 77B, as has also the nature of the activities that are compensable. Generally speaking, except for court officers as such, services to be compensable must go directly to the execution of the plan and to the advancement of the proceedings and its successful consummation. In practice the fundamentals of a plan are often negotiated and formulated before going to court. Such services have been held compensable.

The services that merely duplicate those performed by other persons who are charged with the duty to represent the interests so served are not usually compensatory. While adversary position is the essence of the debtor and creditor relationship, and does not of itself preclude compensation, yet parties who indulge in cantankerous tactics and litigiousness merely for their own sakes are denied compensation.

There are no fixed standards or yard sticks to measure the amount to be allowed, but each applicant must rely upon the merits of his position and his services. Certain principles have been enunciated that govern to a limited extent. Some of the elements or factors that have been taken into consideration are: (a) the time basis; (b) the salary basis; (c) territorial locations as affecting the "cost of doing business"; (d) the magnitude of the task as it may absorb personnel and office facilities; (e) the results obtained, and what particular applicants brought the particular results; (f) comparison with usual allowances for

similar work requiring equivalent skill and experience; (g) difficulties, complexities, novelty of questions presented, size of estate, and amount involved. Hence, the amounts allowed to the various parties representing the several interests in the reported cases do not establish absolute criteria for allowances in other cases.

The 75th Congress passed an act prohibiting parties from making agreements as to fees in receivership and reorganization cases.⁶⁴ The application of the Act is limited, however, to such fees as are to come out of the estate or the reorganization fund.⁶⁵

ROLE OF THE ATTORNEY

It is apparent that the attorney working in bankruptcy reorganization is no longer a mere undertaker; he is a doctor. Much of the success of the proceeding depends on the ability, standing, and character of the attorney representing major interests. The problems of reorganization involve questions of law, finance, corporate management, and even public relations. While the proceeding is largely administrative, every case involves various purely legal questions reaching into many fields of the law. It is, however, in truth a proceeding, and not a law suit where one person is a party litigant in control of the evidence which he wishes to introduce.

The attorney is usually obliged to do most of the work though he may be representing court officers or a committee or the debtor or some other interest. Unfortunately he also bears the brunt of the criticism for which there now seems to be an open season on lawyers. Yet he has also the opportunity to initiate the policies of administration as well as to carry them through. He may direct the activities of committees and other lay representatives of the parties in interest.

The profession has in this field of statutory reorganization all opportunity for a great service in the establishment of our economic system on a sounder basis, while at the same time curing many ills of the excesses of the past. It is a field of endeavor that calls for ingenuity and imagination, skill and knowledge, and should provide satisfaction to the legal mind.

⁶⁴ 28 U. S. C. A. §572(a).

⁶⁵ *In re Trans-State Oil Co.*, 24 F. Supp. 454 (1938).